

# **The Afghan Construction Sector: Opportunities and Obstacles**



**American Embassy Kabul  
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## Background

Afghanistan endured massive destruction over the past 23 years of sporadic war and instability. Some of its provinces such as Kabul, Kandahar, Bamiyan and Balkh were virtually destroyed. Kabul and its surrounding areas bore the brunt of the civil war in the 1990s, and were the focal point of armed conflict throughout the past two decades. The scope of its destruction is far beyond any other province in the country.

Some of the provinces suffered little destruction, but saw no modernization or development for over two decades. Some provinces saw limited local reconstruction efforts, but generally development remained stagnant. Bamiyan was badly destroyed before the establishment of the Transitional Islamic State of Afghanistan (TISA) government. Mazar-e Sharif saw some destruction in the fight between the Taliban and the Northern Alliance and during internal scuffles before the TISA's establishment. Kandahar suffered greatly during the war against the Soviets.

After the establishment of the TISA in April 2002, many local construction companies began operations (esp. in Kabul) but lacked experienced staff. As reconstruction work is progressing rapidly with many donor countries and NGOs involved, almost all local construction companies have ongoing projects. Unfortunately, local firms lack expertise, construction machinery and equipment and construction materials. Most notably, Afghan engineers lack experience in modern construction techniques. Nonetheless, they are taking an active part in the reconstruction process. This role is poised to increase with the growing presence of international construction firms in Afghanistan who can help build local capacity in this critical sector.



## **Opportunities for Construction Sector Development and Investment**

### **Construction Material**

Generally the construction materials need are as follows:

- Sand, crashed rocks (coarse aggregate)
- Cement, mud, bitumen (asphalt)
- Different kinds of wood
- Additives (chemicals)
- Expansion joint material
- Reinforcing steel, wire mesh, metal roofing
- Bricks
- Electrical cables
- Fittings & wire valves
- Light fixtures
- Ground rods
- Roof tiles, flooring
- Sanitary fittings
- Pumps, pump fixtures

Currently, most of the construction materials are imported because Afghanistan does not produce them or produces limited amounts (e.g. cement). Cement, which is one of the most important components in construction, is currently imported from Pakistan and Iran. Several small cement production facilities exist in Afghanistan, but require extensive renovation.

### **Construction Machinery**

Generally the construction machineries needed are as follows:

- Front end loaders
- Bob cats (mini equipment)
- Backhoes
- Bulldozers
- Cranes
- Compactors
- Cranes
- Rock excavator/drills
- Well drilling rigs
- Extension ladders
- Masonry tools
- Wheel barrows
- Tool belts
- Safety harnesses
- Glass cutting equipment

## **Obstacles to Construction Industry Activity in Afghanistan**

Afghanistan sorely lacks domestic machinery or construction equipment. All such equipment needs to be imported. A 7% custom duty is imposed on this equipment, which foreign construction companies are obliged to pay. Until recently the import duty was 20%, but extensive lobbying by the Embassy and others led to a reduction to 7%. Lobbying efforts continue to eliminate the import duty on reconstruction related construction, and the TISA is actively considering eradicating the import duty requirement entirely. Afghan firms enjoy import duty free status in the first year of project operations, but in the second year they also have to abide by the 7% duty.

There is a wide gulf in expertise and competitiveness between local Afghan firms and international firms. Most major projects are awarded to international firms, who have expert engineers, machinery, management and materials. The TISA has encouraged joint ventures (Foreign companies + Afghan companies), and USAID requires Afghan participation for all bidders on the Kabul-Kandahar-Herat road project. Unfortunately, Afghan companies have difficulty taking advantage of these opportunities. Foreign companies demand managerial, planning and accountancy expertise beyond the capacity of virtually all Afghan firms.

The most salient obstacles to growth of trade and investment in Afghanistan generally are: a lack of commercial banking institutions, inadequate property rights protections, a lack of Afghan managerial expertise, and the slow pace of privatization efforts. Construction firms should take note of these factors in preparing their plans for operations in Afghanistan.

### **A Lack of Commercial Banking Institutions**

Afghanistan's Central Bank and subsidiary public banking institutions are attempting to meet the commercial banking needs of international and local business, but their limited capacity and infrastructures have made this difficult. Without adequate banking facilities, firms and NGOs operating in Afghanistan have been obliged to keep large amounts of cash on hand, raising their security risks. The reportedly imminent passage of the TISA's new Banking Law in April/May 2003 may remove the main obstacle to entry of foreign commercial banks to Afghanistan, facilitating enhanced financial and commercial activity.

### **Inadequate Property Rights Procedures**

As with many transition economies, Afghanistan currently lacks a well-structured legal framework to ensure property rights to investors. Under the current investment law, leases of up to 30 years are authorized, with extensions possible with the approval of the High Commission for Investment. Such obstacles may deter some investments with long time horizons for return on

investment, but this factor is less relevant to construction firms. A more important obstacle than limited lease options, however, is the lack of a well-defined procedure for transferring property from public to private hands. As a result, many prospective investors have faced difficulties securing appropriate land sites for their projects.

The TISA is engaged in efforts to establish the regulatory framework for property rights protection, but this process will likely take several years. In the interim, however, one option available to investors is securing short-term leases on properties currently held by a TISA Ministry or one of Afghanistan's 70+ State Owned Enterprises (SOEs). Another option is to enter into a joint venture with an existing firm. Such creative approaches are common to transitional economies and their near-term implementation by proactive firms can help them establish their market presence while legal and regulatory structures are still being developed. Ideally, their early presence may even afford them the opportunity to offer suggestions and guidance to TISA planners in crafting appropriate regulatory structures.

### **Limited Afghan Technical and Managerial Expertise**

A major obstacle to properly structured joint ventures involving Afghan firms is the lack of a relevant corporate law for soundly and predictably structuring such business activities. Second, Afghans and international firms have often find themselves communicating on "different frequencies" when it comes to business. Most Afghan firms lack the necessary managerial experience to respond to international firms' information requests. Few Afghan businessmen speak even passable English, know how to create a business plan, develop financial projections or even employ modern accounting practices. It is critical for companies interested in capacity building to focus on developing Afghan managerial and technical expertise as key elements of their operations in Afghanistan.

### **Slow Pace of Privatization Efforts**

Rather than taking the "Big Bang" approach to privatization, the Afghan government has decided on a very gradual transition to privatizing Afghanistan's many SOEs. Such an approach reduces the risks of instability caused by dislocated employees, and keeps long-standing patronage networks intact, preserving valuable political capital the transitional government is still reluctant to expend. Such a gradual approach, however, risks delaying necessary restructuring efforts beyond the period in which international assistance is readily available, international attention to Afghanistan remains high, and international investors are available to transform inefficient or even defunct SOEs into productive, job-creating private firms. Private sector participation in the conversion of SOEs – through creative property rights arrangements and technical and managerial assistance, for example – may help impel much-needed efforts to rehabilitate, and ultimately privatize appropriate Afghan SOEs.

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